METHODS OF INSURING WORKMEN'S COMPENSATION

By Harwood E. Ryan,

Associate Actuary, State of New York Insurance Department.

The enactment of mandatory laws providing for the payment of work-accident indemnity has created in the United States an exceedingly interesting and important insurance problem. It is scarcely open to argument that a state, in requiring of employers that they shall pay such indemnity, is bound to provide means for making the burden reasonable and one that will not crush the individual employer. Without utilizing the principle of insurance this cannot be accomplished. Insurance at once enables the smallest employer to meet his obligation to provide the statutory indemnities and secures to employes the fulfillment of that obligation in the event of the employer's insolvency.

Workmen's compensation supersedes employers' liability as established by the common law doctrine of negligence. For something like thirty years in this country, employers' liability has been a field for insurance—principally for the joint-stock insurance corporations, but also, to a small extent, for mutual associations. As will presently be seen both of these agencies have been utilized in the transition from the doctrine of fault to that of workmen's compensation. Quite naturally so, since the mechanism of these organizations was already adapted to the needs of the new form of insurance. Operating under liability practice, these companies have developed and maintained elaborate organizations for procuring business, for collecting premiums, investing funds, inspecting risks, investigating accidents and settling claims. These same operations are carried on by them today with the sole—but fundamental—difference that in the adjustment of losses the doctrine of negligence does not enter.

Curiously, the mandatory laws do not invariably provide for compulsory insurance, but most of the elective laws recognize the insurance problem involved and require appropriate measures to be taken for securing the compensation payments.

Carriers of workmen's compensation insurance are of the following types. Their present relative importance is indicated by the

volume of premiums transacted in 1915, the latest year for which figures are now available.

1. Joint-stock companies.....$31,250,000
2. State insurance funds.....7,600,000
3. Mutual employers associations.....4,500,000
4. Reciprocal exchanges—also called inter-insurance exchanges.....2,000,000
5. Self-insurers..... (not comparable)

Eliminating self-insurers, it is logical to group these carriers into two general divisions thus separating the mutuals from the stock companies.

STOCK COMPANIES

First in order of size are the joint-stock companies. These are business organizations which avowedly exist for the purpose of earning profits for shareholders. As before remarked, their entrance into the field of workmen's compensation is due to legislative recognition of existing agencies. These companies as a class have won favor because of their substantial character and the service which they have performed in behalf of employers under common law liability conditions,—the cost of insurance thereunder having been relatively low. Stock companies are required by law to maintain substantial sums (capital stock) for the protection of policyholders and claimants. Such sums are contributed in the first instance by the shareholders and frequently have been augmented from profits. The capital stock of the largest company of this type is six millions of dollars and there is besides more than an equal amount of free surplus over and above the reserves required to mature claims and other obligations.

The management of a stock company is vested in a board of directors. Many of these are business men successful in other lines of activity and are not necessarily insurance men at all. The insurance side of the business is conducted by salaried officials through appropriate committees. Of primary importance is the agency or sales department. The history of insurance the world over affords ample testimony of the necessity—in the absence of monopoly or legal compulsion—of carrying on the business through the instrumentality of paid solicitors.

The cost of acquisition in the field of workmen's compensation insurance is one of the mooted questions. On account of its social

character and of the greater premium cost when compared with employers' liability insurance, the companies have anticipated public criticism and have acquiesced in a reduced acquisition cost brought about by the concerted action of state insurance commissioners throughout the United States. The prevailing limitation of acquisition expense thus imposed is 17½ per centum of the premium charged. In states where the laws require that the employer secure by insurance the payment of compensation, it is an unsettled problem whether this seemingly heavy expense is justified. On the one hand it is claimed that compensation is in principle a tax upon industry, that the state should act as the medium of collection and that the stock company with its agency intermediary is peculiarly out of harmony with such principle. On the other hand it is argued that the agent is not merely a means for securing the business and collecting the premiums but that he performs valuable service to the policyholder in pointing out ways of preventing accidents and thus reducing the insurance rate and that by reason of his pecuniary interest he makes himself useful in obtaining prompt service for the employe in the adjustment of losses.

With one or two unimportant exceptions the stock companies transact business on the plan of guaranteed rates, *i.e.* they do not share profits with policyholders. The contractual relationship is purely a business matter. For the rate stated in the policy the company agrees to pay the indemnities provided by the statutory compensation schedule, and to perform certain service in behalf of the employer, its policyholder. It is customary to include a provision for insurance against common law liability in case particular employes of the assured should be found beyond the scope of the compensation act.

Among the arguments commonly advanced for insuring with a stock company the one of security is all-important. Not that there is magic in that type of organization but that the largest and strongest carriers at present existing happen to be stock companies. As an example it is a matter of recent history that a stock company domiciled in New York has retired from business, its capital impaired. It has successfully reinsured its outstanding workmen's compensation business and will probably pay in full all accrued claims. Other advantages claimed for stock companies are those of long experience in the casualty business and diversification of risk

through the extent of territory covered, thus producing a broad "spread" of the insurance hazard.

Against these are set the disadvantages of higher cost by virtue of stockholders' profits and agents' commissions and of greater operating expense due to the extent of the territory cultivated.

MUTUAL ASSOCIATIONS

Mutual associations may be next considered, for although not second in magnitude, the mutual principle furnishes the alternative to private insurance operated for profit.

Fundamental to mutual insurance is the idea of pooling interests. Groups of employers join together and create a fund out of which the losses are met. From their number a board of trustees or directors is elected and these in turn delegate the details of management to appropriate officers elected by them. A few mutual companies have been in the field for several years undertaking the obligations incident to employers' liability. Such organisms have multiplied in the general workmen's compensation movement which dates from 1910, over forty having transacted business in 1915.

In some states mutual associations have been especially provided by statute as a competitive factor. This is true wherever the insurance of compensation is mandatory, excepting where there is a state monopoly. In one state, viz., Massachusetts, the legislative commission appointed to report upon the (then) proposed compensation law, brought forward a proposal favoring the creation of an employers' mutual association and excluding altogether the stock companies. Existing mutuals, however, were to be allowed to continue. The legislature yielded to the argument that mutual insurance had not demonstrated absolute superiority over stock insurance and that competition should be permitted to decide the issue, the final result being that both forms have been provided for and a valuable experiment in mutual monopoly has been denied us.

With the exception of trade mutuals which generally are formed from the nucleus of trade associations such as millers, brewers, clothing manufacturers, etc., the mutual association transacts business along commercial lines. Like the stock company it is incorporated; the members are jointly liable for the debts of the corporation and the policy contracts contemplate a fixed rate of premium which is designed to pay for the capitalized value of the losses sustained.

It does not operate upon the assessment plan with premiums based upon current cost, but provision is made for assessment of members in case the capitalized losses are in excess of the premiums earned. This assessment feature is in lieu of capital stock and becomes the recourse of creditors in event of the company's insolvency. If the venture is successful, the members share in the profits and so obtain their insurance at reduced rates. The larger and stronger mutual companies employ solicitors, though not always upon a commission basis, frequently substituting therefor the fixed salary method of remuneration. The form of insurance contract adopted by the mutuals is essentially that used by the stock companies excepting for dividend and assessment features.

Mutual insurance offers the prospect of low cost by elimination of shareholders' profits and of part, at least, of the acquisition cost. The control of management is in the hands of the policyholders themselves. Trade mutuals are thus able to secure valuable knowledge of actual insurance cost in their line of business and by so doing to stimulate the granting of equitable rates by other carriers. In theory they are supposed to avoid the poorer classes of risk and so through favorable loss experience to further reduce the cost of insurance to their members. The prospect of dividends is attractive but to some minds is fully offset by the liability to assessment.

The ease with which mutuals may be organized has induced many irresponsible and inexperienced men to promote such institutions. Excepting where state supervision has held in check such tendencies, there is temptation to weaken the financial position of mutual associations by the declaration of excessive, and hence unjustifiable, dividends. Finally, the great bulk of these associations are of very recent origin and are so small that they do not afford adequate protection against occasional severe losses or against the inaccuracies of the rates thus far developed upon insufficient experience under workmen's compensation laws.

STATE FUNDS

Essentially different from the mutual association in organization, in principle the state fund is much the same. It is of European origin and has been introduced here for a variety of reasons. For one thing there was bitter antagonism under the common law between employer and employe. When compensation superseded

liability, labor quite naturally appealed to the state to leave capital out of the question altogether. Also, there was a considerable element among the employed who mistakenly believed that insurance companies were mainly responsible for the old conditions. A further reason for adopting state fund insurance may be discovered in the general tendency toward enlargement of governmental functions.

In the States of Washington, Wyoming, Nevada, Ohio, West Virginia and Oregon, the state fund is of the exclusive or quasi-exclusive type, in some of these states provision being made for self-insurance. Elsewhere it exists in competition with other carriers. In no case does the state pledge its credit to the maintenance of a solvent fund but it usually pays a part or all of the expenses and to this extent may be said to subsidize the enterprise. In California, where the fund is competitive, the legislature provided a cash guarantee which has not been called upon. In New York, the expenses of the fund for two years were paid out of the general treasury with no enactment for return of the monies so advanced. So far as is yet known all of the state funds are conducted on the fixed rate plan which contemplates premiums for capitalized losses. It is to be deplored that more is not disclosed of their transactions. The New York and California funds are managed by experienced insurance men and each has attracted a substantial volume of business. The California fund operates on the same basis of rates as its stock and mutual competitors. The other competitive funds have applied a discount to the private company rates ranging from 5 per cent to 15 per cent.

The largest of the state funds is found in Ohio. Charges have appeared in the commercial and insurance press that the fund is insolvent but as no critical investigation by qualified persons has been made it cannot be stated whether these reports are correct. The management claims it has ample reserves and a small surplus. The Washington fund appears from a recent investigation by the state auditor, to have been badly managed. In West Virginia a provision of law limiting the rate of assessment has seriously embarrassed the fund and a coal mine disaster has added further complications.

State funds derive their income from the premiums paid by employers and from the accretions of interest upon invested assets.

The management is conducted by political appointees who hold office for a term of years or at the pleasure of the appointive power. The policyholders have no voice in the management. The possibility of furnishing satisfactory low cost insurance without state aid is a problem yet unsolved by the state funds. It remains to be seen whether such an organization can be conducted with economy when other governmental enterprises have given rise to waste and inefficiency. Without the highest type of management, these institutions cannot hope to compete successfully against the private carriers. The state fund provides insurance only under the workmen's compensation act and is not authorized to embark upon other lines, such as liability insurance.

In considering arguments for and against state fund insurance, differentiation must be recognized as between those which are competitive and those which are monopolistic or non-competitive. Next to the security of the insurance, the main consideration is that of cost. If monopolistic, the fund is not driven to incur those expenses which competition necessitates in order that the fund may obtain a fair share of business. Otherwise such expenses must appear, at least in part, and a large potential advantage is thereby lost. A state subsidy enables the granting of lower rates but this merely shifts a part of the expense to the community at large and does not effect any real economy. There is small difference between a competitive state fund and a competitive mutual association. It may be presumed that both can attain the same degree of expertness in the conduct of their business. Both aim to reduce the initial cost by returning dividends to policyholders. The competitive effect of both is the same, viz., to regulate the actual cost of insurance by operating as a check against the proprietary companies.

Against the state fund principle the argument is made that, like any other business, insurance should be conducted by private management. It is held also that political considerations must tend to lower the efficiency of such organizations. The absence of direct management control by the policyholders is another objection. Some go so far as to hold that claimants may fare unjustly in order that the funds may make a favorable showing in point of cost. And, as might be expected, there is strong objection to any subvention of a state enterprise which is competing for business against privately managed companies. Some of these arguments are

clearly directed against the administrative features of state funds as laid down by law rather than against the general principle involved. It may be doubted whether any state fund now existing is ideally situated for a thorough-going test of the practicability of the idea.

SELF-INSURANCE

Self-insurance is really non-insurance. The employer simply assumes his own risk and obtains permission from the authorities to deal directly with his employe-claimants or their dependents. It is customary to require of self-insurers a bond or deposit of securities as a guarantee of performance. In addition their financial responsibility is considered. Under some compensation acts, such as that of New York, the benefit in case of death or of permanent total disability takes the form of a pension for life. It is open to serious question whether such benefits, involving the creation of a trust fund, should be left to commercial or industrial organizations for ultimate liquidation. In New York the State Industrial Commission formerly disposed of such cases by requiring payment in a lump sum, to a fund administered by the state, of the capitalized value of future payments but a recent decision by the appellate division of the supreme court has for the present nullified this requirement. The reasoning of the court is not convincing and it is probable that the legislature will be appealed to for the removal of the legal barrier. The administrative body recognizes the danger of exposing such monies to the risk of business failures of self-insurers and seeks to place them in safer hands for liquidation.

It has been argued that self-insurance will work to the disadvantage of labor. It is claimed employers will apply strict standards in engaging employes, that the physically inferior and those with dependent families will be discriminated against. Another claim is that self-insurance leads to coercion of employes who may present claims and to consequent evasion of the spirit, if not direct violation of the letter, of the compensation act. There seems to be no general indication that employers are taking advantage of such openings. Much more serious would seem to be the possibility of leaving substantial sums of compensation unpaid through their insolvency. Self-insurance as a means of securing payment of compensation is somewhat precarious excepting where

there is legal provision for immediate liquidation of amounts due through some trusteeship for administering deferred payments. It is not a complete substitute for regular insurance. The advantages are too largely on the side of the employer. It is no answer to say that many large employers, eligible to carry their own risk, are providing benefits in excess of those granted under workmen's compensation laws. They are in no wise precluded from continuing such plans while providing adequate security, by way of insurance, for the legal rights of employes.

RECIPROCAL OR INTER-INSURANCE

This form of insurance is operated through a so-called "exchange," the actual management being carried on by an attorney-in-fact who generally receives for his services and for expenses of administration a percentage of the premiums transacted. It somewhat resembles a mutual association but differs therefrom in important respects. The liability of subscribers is several and not joint and is generally limited to the amount of one annual premium. The attorney-in-fact enjoys broad powers, and in practice is the substitute for the elective management found in stock and mutual organizations. He has no financial responsibility for the liabilities of the exchange nor is the exchange subject to the close scrutiny of the public authorities as is the case with corporate insurance carriers. The subscribers have no joint assets nor the right to bond one another in any way. The success or failure of a reciprocal exchange depends almost wholly upon the personal ability and integrity of the attorney-in-fact.

In many states these organizations are not permitted to operate. Attempts have been made to secure official recognition through the filing of statements with the state insurance departments. No evidence is at hand to show that the exchanges desire anything approaching real supervision by those authorities.

However appropriate these organizations may be in the realm of fire insurance, where they originated, it is open to question whether they should be permitted to operate without greater restriction and under only nominal supervision by the state. The obligations of workmen's compensation serve to create deferred liabilities which partake of the nature of a trust fund. Such a fund

should be safeguarded to the fullest possible extent if the insurance carrier is to serve a useful purpose in such a field. Under present conditions this is not being done in the case of reciprocal exchanges. Their primary purpose appears to be to afford a remunerative activity for the promoter or attorney-in-fact. In short, so many objections can be raised against reciprocal exchanges as at present conducted, that one fails to see how they may find a place of usefulness in relation to a branch of insurance so peculiarly social in its character as that of workmen's compensation.

CONCLUSION

Through the maze of controversial claims made for the various forms of insurance of workmen's compensation, one sees clearly the single fact that no particular form has reached such a point of excellence that it stands out as superior. The various experiments now undergoing the test of practical experience afford the opportunity for future appraisal. All these forms of insurance must be judged upon the basis of security, cost and service. Self-insurance and inter-insurance seem fairly indictable and doubtless will be the first to pass away. The mutual principle, whether applied through private or through public management, bids fair to survive, even if only as a competitive force inhibiting monopoly by the joint-stock companies. There is no apparent reason why mutual insurance carriers worthy of public confidence and patronage should not develop. The effect of competition thus far indicates a gradual drift in the direction of the strongest and most efficiently managed stock and mutual companies. The largest question involved in the general problem is whether the insurance of workmen's compensation should be conducted competitively or as a monopoly.

Against competition the argument is a compelling one that lost motion results from the agency system which system unnecessarily absorbs a large proportion of the premium contribution. Further waste is introduced at the point where state supervision is invoked to promote equal competitive opportunity among the carriers. If a monopolistic system is created which form shall it assume? The probability is strong that society will not legislate in favor of a proprietary monopoly however efficient. The mutual association and the state fund will be the most likely candidates. Of the two the mutual association should have the greater appeal

because of its representative form of government, its consequent responsiveness to the will of its member-policyholders, and the divorcement from political interference which its scheme of organization renders possible.

Whatever may be the ultimate development of workmen's compensation insurance, it is reasonable to expect that society will insist upon the greatest security and the best service at the minimum cost to itself.